No. 10962

United States Circuit Court of Appeals

For the Ninth Circuit

THE RAILROAD CREDIT CORPORATION, a Corporation,
Appellant,

vs.

FREDERICK H. ECKER, FRANK C. WRIGHT and ROBERT E. COULSON, the members of the Reorganization Committee of the Western Pacific Railroad Company, Debtor,
Appellees,

and

THE WESTERN PACIFIC RAILROAD CORPORATION, a Corporation,
Appellant,

vs.

THE RAILROAD CREDIT CORPORATION, a Corporation,
Appellee.

Opening Brief of The Railroad Credit Corporation as Appellant Upon Its Appeal

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EMPHASIS

All emphasis by use of bold face type is ours.

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I.

STATEMENT AS TO PREPARATION AND PRINTING OF RECORD AND REFERENCES TO IT

This is an appeal from part of an order of the District Court (II-R 143) construing certain provisions of the plan of reorganization of The Western Pacific Railroad Com-

pany, a railroad corporation debtor in reorganization under §77 of the Bankruptcy Act (47 Stat. 147, c. 204, as amended; 11 U.S.C.A. §205). The Interstate Commerce Commission, after extended proceedings, certified a plan of reorganization to the District Court *(Re Western P. R. Co. Reorganization,* 230 Inters. Com. Rep. (F) 61; 233 Inters. Com. Rep. (F) 409; 236 Inters. Com. Rep. (F) 1; I-R 194, 300, 884). The District Court approved the plan *(Re Western P. R. Co.,* 34 F. Supp. 493, 43 Am. Bnkr. Rep. (NS) 328; I-R 1569). From that order appeals were taken to this Court. In this Court the matter was entitled and numbered: "In the Matter of the Western P. R. R. Co., Debtor—Western P. R. R. Corporation, a corporation, et al., Appellants, vs. Institutional Bondholders' Committee, et al., Appellees.", No. 9714.[1] The record was long. Printed copies of it are in the files of this Court. It is herein referred to as "I-R".

This Court reversed the District Court (124 F.2d 136).[2] On certiorari the Supreme Court reversed this Court and affirmed the District Court. *(Ecker v. Western Pacific R. R. Corporation, and companion cases,* 318 U.S. 448, 87 L.ed. 892; the Mandate is at II-R 63).

On going down of the Mandate (directed to the District Court) and on May 9, 1944, the Reorganization Committee under the plan of reorganization, filed a petition for construction of portions of the plan (II-R 69). After a hearing (II-R 109-143) the District Court responded with its

1. The opinion of this Court is reported as *In re Western Pac. R. Co.,* 124 F.2d 136.

2. The grounds have no direct bearing upon the matters presented on these appeals. But had this Court been sustained the present controversy could not have arisen.

corrected memorandum opinion (II-R 98) and its order of September 14, 1944, construing the plan of reorganization (II-R 143). The pending appeals are taken from portions of this order.

Much of the matter which should be before the Court on the pending appeals is contained in the record on the earlier appeals, No. 9714 in this Court. To shorten the record on these appeals and save duplication, this Court made its order that on inclusion of a copy of that order in the record of these appeals there need not be included any matter already in the record in No. 9714, and that such matter should be deemed part of our record on these appeals. A copy of that order was included in our record (II-R 178).

On the filing of the original certified record this Court made its order of January 10, 1945, that it should not be necessary again to print matter appearing in the record in No. 9714; that the parties might refer to the record in No. 9714 as part of the record on these appeals (II-R 200).

Accordingly, the record on these appeals is physically contained in two places, (1) in the record on appeal in No. 9714 in this Court, and (2) in the printed record on these appeals—No. 10962 in this Court. Matter in the record on the earlier appeals, No. 9714 in this Court, will be referred to by arabic numerals designating page preceded by "I-R"; matter contained in the printed record on these appeals No. 10962 in this Court, will be referred to by arabic numerals designating page preceded by "II-R".

II.

JURISDICTION

The pleadings and facts disclosing the basis on which it is contended that the District Court had jurisdiction appear above in Part I of this Brief, and in Part IV (p. 26 below). The jurisdiction of the District Court is sustained by §77 of the Bankruptcy Act (47 Stat. 147, c. 204 as amended, 11 U.S.C.A. §205, particularly subdivisions (a), (f) and (l)), and the consent of the Interstate Commerce Commission and reservation of jurisdiction in Paragraph V of the Plan of Reorganization (I-R 399).[3] (See also Bankruptcy Act §2a(7)(8)(15), 11 U.S.C.A. §11a(7)(8)(15)).

The decree appealed from was made and filed September 14, 1944 (II-R 143). No notice of its rendition or filing was given. The Railroad Credit Corporation notice of appeal was filed October 13, 1944 (II-R 149, 150), and pursuant to order of the Court made on October 14, 1944, a cost bond on appeal was filed on October 14, 1944 (II-R 154-157). The jurisdiction of this Court to entertain this appeal is sustained by Bankruptcy Act §§77(a)(l), 24, 25, 11 U.S.C.A. §§77(a)(l), 47, 48; Jud. Cod. §128(c), 28 U.S.C.A. §225(c). (See also General Orders in Bankruptcy, 49(2), 36.)

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3. This provision of the Plan of Reorganization was set out in the Petition of the Reorganization Committee (II-R 69) and reads as follows: "V. The construction of the Plan by the Court shall be final and conclusive. The Court may cure any defect, supply any omission, or reconcile any inconsistency in such manner and to such extent as may be necessary or expedient in order to carry out the Plan effectively."

III.

STATEMENT OF THE CASE

Background of the present proceedings

The background of the present proceedings can best be stated, shortly and authoritatively, by quotation from the opinion of the Supreme Court[4] (318 U.S. 448, 453-456, 87 L.ed. 892, 920-923).[4] (Some of the court's foot notes have been omitted and the foot note references and foot notes are ours unless otherwise indicated.[5])

"The debtor railroad company filed its petition in the District Court for the Northern District of California on August 2, 1935, alleging its inability to pay and discharge its indebtedness as it matured and praying for reorganization under §77. The petition was approved as properly filed, trustees were appointed, their appointment ratified, 207 Inters Com Rep (F) 793, and the appropriate steps taken to bring the plan of reorganization before the Commission for consideration. Public hearings were held by the Commission at which other plans for reorganization were filed, one by a group of bondholders known as the Institutional Bondholders Committee and one by the A. C. James Company, a secured creditor of the debtor which also was financially interested in the treatment accorded

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4. The statement of the Supreme Court, though shorter, follows substantially the statement of facts by the District Court (34 F.Supp. 493; I-R 1569 et seq.). The Supreme Court itself notices that "there is little if any dispute concerning the primary facts."

From the opinion of the District Court it appears that a pre-trial conference was had. "At the conference the parties agreed upon substantially all the facts upon which depend the decision of the issues raised by the objections and claims for equitable treatment, and, accordingly, on December 20, 1939, filed a 'Stipulation as to Facts Not in Dispute'."

The stipulation as to facts not in dispute will be found in I-R 1017 et seq. By order of the Court it was made part of the record (I-R 1273) and it was received in evidence on the hearing in the District Court (I-R 1285).

5. The second footnotes numbered 5 and 6 below and not appearing in ordinary sequence are part of the Supreme Court's opinion and not our footnotes.

the preferred and common stock of the debtor. After full consideration of the problems of the debtor's reorganization and after the development of a plan deemed in accordance with §77, the Commission certified its plan to the District Court on September 28, 1939.[6]

"The Commission's conclusions and orders were reached upon exceptions to the report of its Bureau of Finance. Its plan was the outgrowth of a study of the financial condition and economic situation of the debtor, viewed in the setting of the public interest in a national transportation system. The competing claims of the various classes of creditors and stockholders were appraised in the light of the requirements of the Act that they be accorded fair and equitable treatment. There is little if any dispute concerning the primary facts from which factual or legal inferences are to be drawn.[7]

"The debtor is a California corporation with its principal operating office in San Francisco. It carries on an interstate railroad business between the States of California, Nevada and Utah. For an understanding of this opinion the obligations of the debtor as of January 1, 1939, the date proposed for the beginning of the operation of the plan, may be stated as follows:[8]

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6. The steps and proceedings before the Commission are outlined in more detail in the opinion of the District Court, in considerable detail in the Stipulation as to Facts Not in Dispute (I-R 1018 et seq.) and, of course, the proceedings themselves appear in full in I-R, the record in No. 9714.

7. See footnote 4 above.

8. The figures which follow are the same as those used by, and which appear in, the opinion of the District Court (34 F.Supp. 493, 497; I-R 1576). The figures are the same as those appearing in the opinion of this Court (124 F.2d 136, 137) except [1] that this Court carried its figures to the nearest even dollar, and except [2] as to the figure for accrued interest on The Railroad Credit Corporation note, where this Court used a slightly larger figure than that used by the District Court, noticed the difference and stated that it was using the Commission's figures. Since this affects only the unsecured portion of the Railroad Credit Corporation claim, the difference is not material, as will appear.

"Claim or interest	Principal of claim or interest	Accrued interest at contract rate to effective date of plan	Total claim including interest at contract rate to effective date of plan
Trustees' certificates (held by Reconstruction Finance Corporation)	$10,000,000.00	$ —	$10,000,000.00
Equipment obligations	2,750,050.00	94,202.00	2,844,252.00
First Mortgage 5% Bonds	49,290,100.00	13,143,776.66	62,433,876.66
Reconstruction Finance Corporation Collateral Notes (secured by $10,750,000 General and Refunding Mortgage Bonds and other collateral*)	2,963,000.00	899,869.98	3,862,869.98
The Railroad Credit Corporation Collateral Notes (secured by $4,000,000 General and Refunding Mortgage Bonds and other collateral*)	2,445,609.88	145,314.23	2,590,924.11
A. C. James Co. Collateral Notes (secured by $4,249,500 General and Refunding Mortgage Bonds)	4,999,800.00	1,249,950.00	6,249,750.00
Total secured debt	$72,448,559.88	$15,533,112.87	$87,981,672.75
Unsecured Claims	5,818,791.00		
Preferred Stock	28,300,000.00		
Common Stock	47,500,000.00		
	$154,067,350.88		

"*The 'other collateral'[9] does not belong to the debtor and is unaffected by the plan. See p. 503 [L.ed. p. 947], infra.

"Payment of this indebtedness was secured by liens, collateral or priority, as follows:

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9. The "other collateral" held by the Railroad Credit Corporation is stated in note (b) in the opinion of the District Court (34 F.Supp. at 497; I-R 1577). That footnote reads as follows:

> "(b) The notes held by RCC are secured by the pledge of $2,000,000, principal amount, of refunding mortgage bonds, series A, and $2,000,000, principal amount, of refunding mortgage bonds, series B, of which $2,000,000, principal amount of series A bonds were repledged with it by ACJ. In addition, such notes are secured by a second lien on all the securities pledged with RFC; by a first lien on the Debtor's distributive share in the fund established by the marshaling and distributing plan, 1931; by a first lien on the advances from WP Corp to the Debtor in the sum of $5,494,722; by a lien on the advances made by WP Corp to Standard Realty and Development Company in the sum of $120,000; and by a lien on the advances made by WP Corp to Sacramento Northern Railway in the sum of $856,260, subject, as to the Sacramento Northern advances, to any and all rights and claims in respect thereof, if any, of the trustees or the holders of first mortgage bonds."

"The trustees' certificates of $10,000,000 are secured by a lien on the entire estate and priority over all claims beyond reorganization expenses.

"The equipment obligations of $2,750,050 are secured by rolling stock, acquired free of the liens of mortgages, through direct liens or trust arrangements. No one disputes the sound character of any of these securities. They are given priority over the fixed obligations of the reorganized company.

"Subject to the trustees' certificates and equipment obligations, the first mortgage 5% bonds of $62,433,876.66, face and interest to the effective date of the plan, are secured by prior liens on all valuable property of the debtor, except (1) money, accounts, operating balances and cash items and (2) certain assets, referred to in the next paragraph, upon which the general and refunding bonds have a first lien, deemed by the Commission to be of value sufficient to support $732,010 of new income mortgage bonds and new preferred stock of $1,147,955 par. The total face and assumed value of the securities authorized by the plan, as evidence of the entire value of the system, is $84,000,000 plus. See page 481 [L.ed. p. 936], infra. This paragraph reflects our conclusions as to priorities of the liens of the respective mortgages later discussed. See *Priorities of Conflicting Liens,* page 489 [L.ed. p. 940], infra.

"The later general and refunding mortgage bonds, $18,999,500 in face amount, are secured by a first lien on properties determined by the Commission to be of a value and earning power sufficient to support issues of new

income bonds and participating preferred stock of $732,010 and $1,147,955, respectively. See 233 Inters Com Rep (F) 414, et seq. They are further secured, subject to the prior rights and other exceptions of the obligations listed in the preceding paragraphs, by a lien on all valuable property of the debtor. All of this series which were issued are pledged to secure the collateral notes in the amounts indicated in the preceding table."

The Supreme Court next reviews facts bearing upon the questions of value and the character and amount of new securities which would be supported and which properly should be issued,[10] states the conclusions of the plan as to securities to be issued and continues (318 U.S. at 460, 461, 87 L.ed. at 925):

"In view of the foregoing limitation, capitalization of the reorganized company was fixed at $2,750,050 of undisturbed equipment obligations, $10,000,000 of first mortgage 4% bonds, $21,219,075 of income mortgage 4½% bonds, $31,850,297 of 5% preferred stock, and 319,441

10. The heart of this discussion is the anticipated earnings of the debtor, the fixed demands on those earnings, and the capital structure that the earnings would support.

shares of common stock without par value.[5] These issues of preferred and common were based upon possible earnings in addition to the $2,000,000 plus. These securities were allotted by the Commission upon consideration of 'the relative priority, value, and equity of the various claims and the value of the new securities available in exchange therefor,' as follows:[6]

"5. 233 Inters Com Rep (F) 409, 413; 236 Inters Com Rep (F) 1, 4. This is summarized by a petitioner as follows:

Title of Issue	*Presently to be issued*	*Annual Charges*
Undisturbed existing equipment obligations	$ 2,750,050	$ 94,202
First Mortgage 4% Bonds, Series A, due January 1, 1974	10,000,000	400,000
Total annual fixed charges		$494,202
Mandatory Capital Fund		500,000
Income Mortgage 4½% Bonds, Series A, due January 1, 2014. Interest cumulative to 13½%, otherwise noncumulative. Convertible at the option of the holder into new Common Stock at the price of $50 per share	$21,219,075	954,858
Total funded debt	$33,969,125	
Total annual charges (fixed and contingent) and Capital Fund		$1,949,060
Income Mortgage Sinking Fund (½%)		106,095
Participating 5% Preferred Stock ($100 par value)	31,850,297	1,592,515
Total securities with par value	$65,819,422	
Total annual charges, Capital Fund, and Preferred dividend requirements		$3,647,670
Common Stock (without par value)	319,441 shs.	

(Supreme Court footnote. The table is substantially the same as one in the opinion of the District Court, 37 F.Supp. at 496; I-R 1575. There is no difference as to figures.)

"6. The applicable portion of the finding is as follows:

'(1) First-mortgage bondholders, $19,716,040 of income-mortgage bonds, $29,574,060 of preferred stock, and 230,593 shares of common stock, the common stock to be taken at the price of $57 a share; (2) Finance Corporation, $1,185,200 of income-mortgage bonds, $1,777,800 of preferred stock, and 15,788 shares of common stock, the common stock to be taken at a price of $57 a share; (3) Credit Corporation, $154,111 of income-mortgage bonds, $241,681 of preferred stock, and 35,425 shares of common stock, the common stock to be taken at a price of $62 a share; and (4) James Company, $163,724 of income-mortgage bonds, $256,756 of preferred stock, and 37,635 shares of common stock, being the amount of common stock which bears to the amount of common stock allotted to the claim of the Credit Corporation the same proportion that the principal amount of general and refunding bonds of the debtor held by the James Company as collateral for its claim bears to the principal amount of such bonds held by the Credit Corporation for its claim.' The result of the distribution per dollar of indebtedness is set out in the Commission's reports. 230 Inters Com Rep (F) 101 and 233 Inters Com Rep (F) 417 and 451." (Supreme Court footnote). This is **not** an exact quotation of the Plan of Reorganization. (See subdivision P quoted at p. 26 below.)

	New First Mortgage 4% Bonds Series A	New Income Mortgage 4½% Bonds Series A	New 5% Preferred Stock Series A ($100 Par)	New Common Stock (No Par)
"First Mortgage 5% Bonds ($62,433,876.66)		$19,716,040	$29,574,060	230,593 shs.
RFC (In exchange for Trustees' Certificates of $10,000,000 and Collateral Notes of $3,862,869.98)	$10,000,000	1,185,200	1,777,800	15,788 shs.
RCC Collateral Notes ($2,590,924.11)		154,111	241,681	35,424 shs.
ACJ Collateral Notes ($6,249,750)		163,724	256,756	37,635 shs.
Total	$10,000,000	$21,219,075	$31,850,297	319,441 shs."

The basis of this allocation is given below at page 18 and following. It is now necessary to notice in more detail the position of The Railroad Credit Corporation.

The position of The Railroad Credit Corporation

The table at p. 7 above and the stipulation as to facts not in dispute show that the Debtor had issued $18,999,500 principal amount of General and Refunding Mortgage Bonds. These bonds were a first lien on certain of the assets of the Debtor (318 U.S. 448, 489, et seq., 87 L.ed. 892, 940, et seq.). None of these were issued except by way of pledge as collateral to secure loans made by the A. C. James Co., Reconstruction Finance Corporation and The Railroad Credit Corporation (I-R 1022, 1023).

To secure its indebtedness to the A. C. James Co. the Debtor pledged to the A. C. James Co. $6,249,500 principal amount of its General and Refunding Bonds (I-R 1023). To secure advances from Reconstruction Finance Corporation principal and interest totaling $3,862,869.98, the Debtor pledged $10,750,000 principal amount of its General

and Refunding Bonds (see table p. 7 above). The Railroad Credit Corporation acquired certain rights in respect of both the bonds pledged to James Co. and bonds pledged to Reconstruction Finance Corporation.

The claim of The Railroad Credit Corporation was secured in various ways. The security it held was as follows:[11]

(1) $4,000,000 of General and Refunding Bonds of the Debtor. Of these $2,000,000 were pledged directly by the Debtor and $2,000,000 were bonds originally pledged by the Debtor to the James Co. and repledged by the James Co. with The Railroad Credit Corporation (I-R 1023, 1025; see note 9 above).

(2) "A second lien upon all of the securities pledged with the Reconstruction Finance Corporation as collateral security", i.e., a second line on the $10,750,000 principal amount of General and Refunding Bonds pledged to Reconstruction Finance Corporation as noticed above (I-R 1025; see note 9 above).

(3) "A first lien on Debtor's distributive share in the fund established under The Marshaling and Distributing Plan, 1931"[12] (I-R 1025; see note 9 above).

(4) A first lien on certain advances made by The Western Pacific Railroad Corporation to the Debtor and to subsidiaries of the Debtor (I-R 1025; see note 9 above).

The question on this appeal turns on the place occupied by, and what is to be done with, (3) above, i.e., "the Debtor's distributive share in the fund established under The Marshaling and Distributing Plan, 1931". A copy of this Marshaling and Distributing Plan, 1931, appears as an exhibit an-

11. See note 9 above.

12. Is this a "lien" or a contractual right of set-off?

nexed to the claim of The Railroad Credit Corporation filed in the reorganization proceeding (II-R 5-43). The Plan arose out of a proceeding before the Interstate Commerce Commission, "Fifteen Per Cent Case, 1931, Ex Parte No. 103—In the Matter of Increase in Freight Rates and Charges".

This is the crux of the Marshaling and Distributing Plan, 1931 (II-R 10 et seq.): The railroads had applied for a horizontal increase in freight rates. This was needed for the financially weak roads, and, of course, would substantially increase the earnings of the strong roads. As a result of the rulings of the Interstate Commerce Commission, a pooling arrangement was established, which is known as the Marshaling and Distributing Plan, 1931. Under this Plan carriers which contributed to the fund created thereby were eligible to file applications for loans to meet their fixed interest obligations. When made, these loans were secured by the best available collateral. The Railroad Credit Corporation was incorporated as the agency through which the Plan would operate. The roads participating in the Plan made contributions to a fund held and administered by The Railroad Credit Corporation. "The amount to be paid into the fund, by each of the participating carriers, shall be the gross revenue received by it from the increase of rates scheduled by the Commission", less certain amounts on account of taxes. The Railroad Credit Corporation was to use the fund so provided "to carry out the Commission's purpose to prevent, so far as practicable, defaults by railroad companies in their fixed interest obligations". To that end the Corporation, on application of a participating eligible carrier, would make loans from the funds to enable the carrier to meet its fixed interest obligations. The Corporation was to take as se-

curity the best available collateral, including, if required by the Corporation, the pledge "of the amounts due or to become due an applicant on distribution as provided" in the Plan.[12] The directors of the Corporation were to review its needs, and if they found a balance on hand above requirements, "such balance shall be distributed to the participating carriers in the proportion in which their respective earnings * * * contributed to the fund, **except that any distributable amount inuring to a carrier indebted to the fund, instead of being paid to it, shall be credited on its obligation**".[13]

In pursuance of the Plan, The Railroad Credit Corporation was incorporated and The Western Pacific Railroad Company, the Debtor, became a participating carrier and made contribution. The contributions of the Debtor and its subsidiaries, and the right of the Debtor and its subsidiaries to receive distribution, were treated as a unit.

The notes of the Debtor were given under the Plan. The Debtor made applications for loans and received two loans, one in the principal amount of $1,303,000, evidenced by its note of June 29, 1932 (II-R, 44-51) and one in the principal amount of $1,293,439, evidenced by its note of March 25, 1933 (II-R 52-59). (See also I-R 1056, 1057.) These notes, in addition to stating the principal obligation and the obligation to pay interest, specified the security given. Under the first note, the security was the Debtor's distributive share under the Marshaling and Distributing Plan[14] and the Debtor's rights in all collateral given to the Reconstruction Finance Corporation, subject to the

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13. A contractual right of set-off. *Poindexter v. Greenhow*, 114 U.S. 270, 29 L.ed. 185, commented on in *McGahey v. Virginia*, 135 U.S. 662, 685, 34 L.ed. 304, 312, col. 2.

14. A "pledge" or a contractual right of set-off?

lien of the latter. The second note was secured by the same collateral and also by $2,000,000 General and Refunding Bonds pledged by the Debtor, $2,000,000 General and Refunding Bonds furnished directly by the James Co. and evidences of claims of The Western Pacific Railroad Corporation for advances against the Debtor and certain of its subsidiaries, said claims being furnished by The Western Pacific Railroad Corporation as accommodation collateral.

Both of the Debtor's notes to The Railroad Credit Corporation, in respect of the distributive share of the Debtor under The Marshaling and Distributing Plan, 1931, provided that the Debtor "agrees * * * to pledge[14] and does hereby pledge[14] with the payee the Railroad Company's share in the fund established under the aforesaid plan, as the same may be at any time and from time to time determined * * *. * * * the securities hereby pledged * * * as security for this or any other obligation of the Railroad Company to the payee, shall be applicable in like manner to secure the payment of any and all such obligations. And all such securities in the hands of the payee shall stand as one general continuing collateral security for the whole of said obligations so that the deficiency on any one may be made good by enforcement of the rights and remedies of the payee in respect of the sale of collateral or otherwise as to the rest and the Railroad Company hereby gives to the payee a lien for the amount of all of the liabilities aforesaid upon all other property of the Railroad Company at any time coming into the possession of the payee." The payee is given the right to "itself purchase the whole or any part of the securities". The Railroad Company "further authorizes the payee, at its option, at any time, **to appropriate and apply to the**

payment of any of the aforesaid liabilities, whether now existing or hereafter contracted, any or all property now or hereafter in the hands of the payee belonging to the Railroad Company, whether the aforesaid liabilities are then due or not due."[15]

The principal amount of the claim of The Railroad Credit Corporation, stated in the table at page 7 above, was the principal amount of these notes reduced by $150,829.12 of distributions under The Marshaling and Distributing Plan, 1931. In addition, as of November 30, 1939, there was under the Marshaling Plan, an undistributed book balance to the Debtor and to its subsidiaries of $53,541.39 (I-R 1056, 1057, 1211-1213). Of this amount $26,091.72 only is involved here.[16]

The following appears in the District Court's "Order Approving Plan of Reorganization of Debtor":

> "The Court finds:
>
> "1. The findings of fact made by the Interstate Commerce Commission in its original report of October 10, 1938, as modified by its supplemental report of June 21, 1939, are supported by the evidence, and as supplemented by the stipulation of the parties filed herein on December 20, 1939, **are adopted as Findings by this Court.**" (34 F. Supp. 493, 505 col. 2; I-R 1601.)

The Commission, in its supplemental report of June 21, 1939—"Report of the Commission on Further Consideration"—found as follows as to the second item of security

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15. A contractual right of set-off waiving any claim that it could not operate prior to maturity of the debt. See note 13 above.

16. The balance which accumulated after the effective date of the Reorganization Plan was $26,091.72. (See p. 30 below.)

of The Railroad Credit Corporation, its second lien on the General and Refunding Bonds pledged with Reconstruction Finance Corporation (item (2) p. 12 above):

> "In this connection we also find that such allocation of reorganization securities to the Finance Corporation **exhausts the value of the collateral pledged by the Debtor** under the notes held by the Finance Corporation, and that **the equity of the Credit Corporation in such collateral has no value.**" (I-R 316.)

In its order of the same day, the Commission set out the final reorganization plan which was approved by the District Court and the Supreme Court. In that order and plan the following appears:

> "**The Railroad Credit Corporation's equity in the collateral securing the claim of the Reconstruction Finance Corporation is found to be without value.**" (I-R 392.)

If the Reconstruction Finance Corporation's claim (principal and interest amounting to $3,862,869.98, see table p. 7 above) exhausted security consisting of $10,750,000.00 General and Refunding Bonds of the Debtor and other collateral (as the Commission found), we have a definite **finding** that however much less in value those bonds might be, **they could not be worth more than 359.3367 per 1,000 of principal amount plus interest.** It follows that $4,000,000.00 principal amount of these same General and Refunding Bonds (including interest) pledged with The Railroad Credit Corporation as collateral (see p. 7 above), while they might have a lower value, **could not have a value of more than $1,437,346.00.** The claim of The Railroad Credit Corporation, principal and interest, was $2,590,-

924.11 (see table p. 7 above).[17] **It exceeded the value of the security held in the form of General and Refunding Bonds by $1,153,578.00.**[17] To that extent Credit Corporation was unsecured unless it had other security. To this we shall return after the issue has been presented. It is enough to notice here that the only other security Credit Corporation had, which could be said to come from, or be property of, the Debtor, was the Debtor's distributive share under the Marshaling Plan, 1931.

If the Debtor's distributive share under the Marshaling and Distributing Plan be considered merely a set-off under a contractual right, then the only effect was to reduce the unsecured portion of the Railroad Credit Corporation's claim. Such treatment, we will show, would have no effect upon the new securities to be distributed to The Railroad Credit Corporation. If, however, this distributive share be considered as pledged to The Railroad Credit Corporation, then the Credit Corporation had a senior and first lien on this distributive share (indeed, no other creditor had any lien on the distributive share) and had a claim which would completely exhaust this security as well as any other security which the Debtor had given (see below p. 35). (The amount of this distributive share in question is only $26,091.72. See below p. 30.)

The method of distribution of new securities under the Plan of Reorganization

The way in which the Commission determined what new securities should be issued and how they should be

17. We are postponing for the moment consideration of the effect of the contractual set-off provided for. See notes 13 and 15 above. To preserve identity we are still using the figures in the table at p. 7 above.

allotted, is of high importance. It appears in some detail in the reports and orders of the Commission and in the decision of the Supreme Court. The District Court was satisfied to say simply that it was in accord with the conclusions reached by the Commission, and that further discussion would be superfluous. The matter is so far beyond dispute that it can be stated without detailed references to the record.

The prospective income of the Debtor was calculated. It was then determined what calls there would be upon that income and what would be available to support a capital structure. This having been ascertained, the capital structure was then determined. It was found that the securities which properly could be issued (the capital structure determined upon) against the income were not sufficient to do more than satisfy existing liens on the property of the Debtor. **Unsecured claims were expressly found to be valueless** (Commission Report of Oct. 10, 1938, I-R 269; I-R 279; Order of Oct. 10, 1938, I-R 294; Final Plan, Order of June 21, 1939, subd. P-6, I-R 392; 34 F. Supp. 493, 498, 507, I-R 1579, 1605) and, of course, where any creditor had a lien but that lien was insufficient to satisfy its claim, to the extent that the lien was insufficient the claim was valueless **against the Debor.** Such claims were excluded from consideration. One of the points of the decision of the Supreme Court was that

> "we hold that the elimination of the claims of stockholders and creditors which are valueless from participation in the reorganization is in accordance with valid provisions of §77(e)." (318 U.S. 448, 475, 87 L.ed. 892, 933.)

This is the finding and holding which the Supreme Court says the Commission was made "correlative to and as a basis for its allocation of securities" (318 U.S. 448, 462, 87 L.ed. 892, 926).

If unsecured claims were valueless it was because the Debtor's property was exhausted by liens of secured creditors. The necessary correlative is that the only creditors entitled to participate in distribution of the Debtor's property, through the issuance of new securities, were the holders of liens on that property; that they so participated by receiving new securities, to the extent of the liens held. The Commission expressed it by saying that the new securities "represent the equitable equivalent of the Debtor's assets available for the satisfaction of claims" (I-R 316). The Supreme Court said:

> "Findings were made as to the property covered by the different mortgages of the debtor and securities allocated on the basis of that finding. * * * The important element is the allocation of the securities so as to preserve to creditors the advantages of their respective priorities." (318 U.S. at 483, 87 L.ed. at 937.)

The only concern was an equitable distribution of the assets of the Debtor through issuing new securities. The plan was concerned with claims and securities held by the creditors only insofar as they bore on this problem. Since the liens exhausted the Debtor's property, unsecured claims were out of the picture. The only concern then was with liens held by the creditors insofar as they bore on distribution, and, of course, the only liens of any creditors which had any relevancy on that question were liens on

the Debtor's property to be thus distributed. This the Supreme Court made clear in its discussion under the heading "Accommodation Collateral" (318 U.S. at 503, et seq., 87 L.ed. at 947 et seq.). (And see p. 34 below.)

How the Commission worked out its problem is dealt with in such detail in its reports and orders, and in the opinion of the Supreme Court of the United States, that there is no occasion to repeat it here. It was found that the first mortgage was a prior lien on certain assets, and that the General and Refunding Bonds were a prior lien on other assets. Adjustment was made for this, and a distribution was then made to the first mortgage bondholders and to Reconstruction Finance Corporation, which for reasons not material here, was given preferential treatment and was put upon the same basis as holders of first mortgage bonds. The remaining securities available for distribution were distributed to the only two remaining secured creditors, The Railroad Credit Corporation and the James Co.

In making this distribution the allocation was made to these creditors solely upon the basis of the liens they held in the form of General and Refunding Mortgage Bonds.[18] The total amount of their respective claims was disregarded.[18] **The pledge (if it can be called a pledge) of the Debtor's distributive share under the Marshaling and Distributing Plan, 1931, was not considered.** No allotment was made in respect of it. Allocation was **solely** on the basis of General and Refunding Mortgage Bonds held.

18. There is nothing peculiar to §77 proceedings in this method of adjusting rights of creditors of an insolvent. The common-law rule is the same. *First Nat. Bk. of Ottawa v. Kay Bee Co.*, 366 Ill. 202, 7 N.E.2d 860.

There is some difference in allocations between the Commission's first report and its supplemental report. This was because the first report proceeded on the assumption that the General and Refunding Mortgage Bonds were not a first lien on any assets. This was corrected in the supplemental report. But in making a change the Commission adhered to the fundamental principle of distribution of new securities only for General and Refunding Bonds.

In its original report the Commission, after pointing out that the securities distributable to The Railroad Credit Corporation and the James Co. "are inadequtae in value to satisfy the aggregate claims of these parties", went on to say that

> "it follows that it would be inequitable to distribute such stock in the proportion that each **claim** bears to the total amount of such stock. **The value of each of the claims is proportionate to the collateral securing it,** and we find that the **allotment of the stock should be made on the basis of the collateral held rather than on the amount of the claims.**" (I-R 271; see also I-R 269.)

In harmony the Commission's original proposed plan provided:

> "The Reconstruction Finance Corporation, Railroad Credit Corporation, and A. C. James Company, holders of the Debtor's notes which are **secured by the pledge of the Debtor's General Mortgage Bonds,** to receive in exchange therefor and for accrued unpaid interest thereon, 159,462 shares of new no-par-value common stock, **the stock to be distributed among them on the basis hereinbefore described,** * * *." (I-R 278.)

The conclusion of the Commission in its second report is:

"From the foregoing, it appears that the creditors **secured by the general and refunding mortgage bonds** should be awarded new income-mortgage bonds in the amount of $732,010, and new participating preferred stock of a par value of $1,147,955. **Applying to these amounts the proportionate amounts of general and refunding mortgage bonds securing the notes** of the Finance Corporation, The Credit Corporation, and the James Company, the Finance Corporation would receive $414,175 of income-mortgage bonds and $649,518 of new preferred stock, the Credit Corporation $154,111 of income-mortgage bonds, and $241,681 of new preferred stock, and the James Company $163,724 of income bonds and $256,756 of new preferred stock for part of their claims. However, this allocation will apply only to the Credit Corporation and the James Company, for as appears herein, we approve the allocation of new securities to the Finance Corporation on a different basis, i.e., on the basis upon which securities are allocated to the holders of existing first-mortgage bonds. * * * The above modifications require further modification of our prior report and order with respect to the allocation of the reorganization securities." (I-R 315, 316.)

The Commission then states its new allocation:

"**Based upon our conclusion as to the relative priority, value, and equity of the various claims** and the value of the new securities available in exchange therefor, we find that the new securities should be allotted as follows: (1) First-mortgage bondholders, * * *; (2) Finance Corporation, * * *; (3) Credit Corporation, $154,111 of income mortgage bonds, $241,681 of preferred stock, and 35,425 shares of common stock,

(the common stock to be taken at a price of $62 a share); and (4) James Company, $163,724 of income mortgage bonds, $256,756 of preferred stock, and 37,635 shares of common stock **(being the amount of common stock which bears to the amount of common stock allotted to the claim of the Credit Corporation the same proportion that the principal amount of general and refunding bonds of the debtor held by the James Company as collateral for its claim bears to the principal amount of such bonds held by the Credit Corporation for its claim)**. We will modify our prior report and order accordingly." (I-R 317, 318.)

The District Court expressed the result as follows:

"RCC and ACJ are allotted new securities on the following basis: From the new securities, which the Commission finds are properly **issuable in respect of the refunding mortgage bonds** held as collateral for the RFC, RCC and ACJ notes, are deducted that proportion of each class which the principal amount of **refunding mortgage bonds** held by RFC as collateral bears to the total amount of pledged refunding mortgage bonds. The balance of such new securities is then **divided between RCC and ACJ in proportion to the principal amounts of refunding mortgage bonds** held by them, respectively, as collateral." (34 F. Supp. at 498 4 col., I-R 1579.)

The Supreme Court said that the "allocation was based" not upon the claims but "upon the 'relative priority value and equity of the various claims.' "

Finally, in the opinion of the District Court underlying the order from which this appeal is taken, the District Court had this to say:

"The Railroad Credit Corporation claims that * * * the new securities are based on the amount of general and refunding mortgage bonds held by it as collateral for its claim, and not on the amount of its claim; * * *. * * * In its approval of the plan issued October 10, 1938, (later modified in other respects) the intention of the Interstate Commerce Commission is shown: 'The value of each of the claims is proportionate to the collateral securing it, and we find that the **allotment of the stock should be made on the basis of the collateral held** rather than on the amount of the claims.' **There is no doubt that the allotments were made on the basis contended for by The Railroad Credit Corporation.**" (II-R 104, 105.)

Nothing could make this clearer than to compare the allocation to the James Co. (whose claim far exceeded that of the Credit Corporation, but whose holding of General and Refunding Bonds was about the same) with the allocation to the Credit Corporation. (See tables at pp. 7 and 11 above, and see pp. 53 and 54 below.)

From the foregoing it is clear that nowhere was any consideration given to the Debtor's distributive share under the Marshaling Plan, 1931, as a factor in determining the amount or character of new securities to be allocated to The Railroad Credit Corporation.

IV.

THE TERMS OF THE REORGANIZATION PLAN SUBMITTED FOR CONSTRUCTION AND THE ISSUE PRESENTED.

Terms of the Plan of Reorganization

The foregoing is the setting for Parts P[19] and R of the Plan of Reorganization. It provides:

> "P. The existing securities of the debtor shall be treated as follows:
>
> "1. Existing equipment trusts, Baldwin lease, and Pullman contract, aggregating $2,750,050 shall remain undisturbed and shall be assumed by the reorganized company.
>
> "2. Holders of existing first-mortgage bonds shall receive for each $1,000, principal amount thereof, together with $266.66⅔ of the interest accrued and unpaid thereon to January 1, 1939, **approximately**[20] $400 of income-mortgage 4½ percent bonds, series A (being 40 percent of the principal amount of said existing bonds); $600 of 5-percent preferred stock, series A (being 60 percent of the principal amount of said bonds); and 4.67 shares of common stock (being common stock taken **at the price of $57 a share**[20] for 100 percent of said accrued and unpaid interest).
>
> "3. The Reconstruction Finance Corporation shall receive in respect of the $10,000,000 of new money provided for in subdivision O (or the surrender of trustees'-certificates at their principal amount and accrued interest, to a like amount) and its existing claim in the principal amount of $2,963,000, together

19. The quotation in note 6 of the Supreme Court opinion (see this footnote quoted at p. 10 above) is not an exact quotation of subdivision P.

20. The occasion for this emphasis will appear below at p. 50 et seq. Notice that the word "approximately" appearing in the Plan does not appear in the report. See p. 23 above.

with $899,870 of interest accrued and unpaid thereon to January 1, 1939, **approximately**[20] $10,0000,000 of new first-mortgage 4-percent bonds, series A (being 100 percent of said new money), $1,185,200 of income-mortgage 4½-percent bonds, series A (being 40 percent of the principal of said claim); $1,777,800 of 5-percent preferred stock, series A (being 60 percent of the principal of said claim); and 15,788 shares of common stock (being common stock taken **at the price of $57**[20] **a share** for 100 percent of said accrued and unpaid interest).

"4. The Railroad Credit Corporation shall receive in respect of its claim in the principal amount of $2,455,610,[21] together with $146,503 of interest accrued and unpaid thereon to January 1, 1939 (subject to the reduction of **said amounts**[22] by the application, prior to the date of issue of the new securities under the plan, of any proceeds from the distributive shares of the company or its subsidiaries under the marshaling and distributing plan, 1931), **approximately**[20] $154,111 of income mortgage 4½-percent bonds, series A; $241,-681 of 5-percent preferred stock, series A; and 35,425 shares of common stock (being common stock taken **at the price**[20] **of $62 per share**). The Railroad Credit Corporation's equity in the collateral securing the claim of the Reconstruction Finance Corporation is found to be without value.

"5. The A. C. James Company shall receive in respect of its claim in the principal amount of $4,999,800, together with $1,249,950 of interest accrued and unpaid thereon to January 1, 1939, $163,724 of income mortgage 4½-percent bonds, series A; $256,756 of 5-

21. This figure seems to be a typographical error. Everything else in the record indicates that it should be $2,445,610.

22. That is, the amounts of the **claim**, not the amount of new securities.

percent preferred stock, series A; and 37,635 shares of common stock **(being an amount of common stock which bears to the amount of common stock allotted to the claim of the Railroad Credit Corporation the same proportion that the principal amount of general and refunding mortgage bonds of the Debtor held by the A. C. James Company as collateral for said claim, bears to the principal amount of such bonds held by the Railroad Credit Corporation as collateral for its claim).**

"6. The unsecured claims of the Western Pacific Railroad Corporation and the Western Realty Company, and other unsecured claims not entitled to priority over existing mortgages, are found to be without value, and no securities or cash shall be distributed under the plan in respect of these claims.

"7. The capital stock of the Debtor is found to be without equity or value, and the stockholders shall not be entitled to participate in the plan.

"Q. * * *.

"R. The Capital Stock of the Debtor * * * shall be cancelled.

"Existing mortgages on the Debtor's property shall be released and cancelled, * * *. All collateral pledged by the Debtor as security for notes to the Reconstruction Finance Corporation, The Railroad Credit Corporation, and the A. C. James Company shall be reduced to possession by the respective pledgees thereof, and shall be by them surrendered to the reorganized company and cancelled, **except** that The Railroad Credit Corporation shall **not** release or surrender any right or interest in the distributive shares of the debtor or its subsidiaries under the Marshaling and Distributing Plan, 1931, but any proceeds from such distributive

shares after the effective date of the plan shall become the property of and be retained by the Railroad Credit Corporation, but to the extent to which received **prior to the issue of the new securities** under the plan shall be applied in reduction of the **claim** of The Railroad Credit Corporation in respect of which new securities are to be issued[23] at the rates provided in subdivision P. * * *." (I-R 390-395.)

The effective date of the plan is fixed as January 1, 1939 (I-R 363).[24]

Proceedings presenting the issue

On May 9, 1944, after the mandate came down affirming the District Court judgment affirming the plan, the Reorganization Committee provided for in the plan filed in the District Court its petition for an order construing the plan of reorganization (II-R 69-94). Part II (II-R 72-76) presented the issue touching proper treatment of the Debtor's distributive share under the Marshaling and Distributing Plan, 1931. The petition quotes Paragraphs 4 and 5 of subdivision P of the Plan of Reorganization (p. 27 above), part of subdivision R (quoted above at p. 28), the opinion of the District Court dealing with the allotment of securities to The Railroad Credit Corporation and the James Co. (quoted at p. 24 above), and alleges that since January 1, 1939, The Railroad Credit Corporation has received from the distributive share of the Debtor under the Marshaling and Distributing Plan, 1931, $26,091.72,

23. This shows a curious confusion. The new securities were not issued "in respect of" any claim, but were issued "in respect of" the Refunding Mortgage Bonds. See p. 18 et seq. above.

24. And see the opinion of the Supreme Court, p. 6 above.

and that it may receive more. It is then alleged that while The Railroad Credit Corporation concedes that anything received from the distributive share will reduce the amount of the claim it has also taken the position that this does not reduce the amount of securities issuable to The Railroad Credit Corporation.

Determination below

After a hearing (II-R 109-143) the District Court filed a corrected memorandum opinion (II-R 98-108). It said that "the Interstate Commerce Commission has made no recommendation" and has stated that the matter was to be determined by the Court; that since January 1, 1939, The Railroad Credit Corporation has received under the Marshaling and Distributing Plan $26,091.72, and that petitioners contend that the amount of securities to be allotted to it should be reduced by the proceeds of this distributive share. It concluded that the construction contended for by the petitioners was proper (II-R 101-106). Counsel were directed to prepare a decree.

A decree was prepared, signed and filed (II-R 143-148). The pertinent provisions are:

> "The Court further finds and concludes:
>
> "* * *
>
> "(b) That the provisions of subdivisions P and R of the Plan of Reorganization (quoted in Paragraph 5 of the petition),[25] which relate to the application of the proceeds of the distributive shares of the Debtor and its subsidiaries under the Marshaling and Distributing Plan of 1941 [1931], require a reduction in

25. Quoted at p. 27 above.

the number of shares of common stock allocated to The Railroad Credit Corporation under Paragraph 4 of subdivision P by one share for each $62 of such proceeds received by The Railroad Credit Corporation after December 31, 1938, and prior to the issuance of the new securities under the plan;

"* * *

"NOW THEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED:

"* * *

"(3) That the provisions of subdivisions P and R of the Plan of Reorganization, which relate to the application of the proceeds of the distributive shares of the Debtor and its subsidiaries under the Marshaling and Distributing Plan of 1931, be, and are hereby, construed as requiring a reduction of the number of shares of common stock allocated to the Railroad Credit Corporation under Paragraph 4 of subdivision P of the plan by one share for each $62 of such proceeds received by The Railroad Credit Corporation after December 31, 1938, and prior to the issuance of the new securities under the plan; * * *."

These are the provisions appealed from.

V.

SPECIFICATION OF ERRORS

Position of The Railroad Credit Corporation

The Court erred (1) in holding that the receipt by The Railroad Credit Corporation after December 31, 1938, of any distributive share of the Debtor or any of its subsidiaries under the Marshaling and Distributing Plan, 1931,

had any legal effect, so far as the reorganization of the Debtor is concerned, beyond reducing the amount of the claim of The Railroad Credit Corporation against the Debtor, and (2) in holding that it required a reduction in the number of shares of common stock allocated to The Railroad Credit Corporation under Paragraph 4 of subdivision P of the Plan of Reorganization. Reference is made to the statement of points on which appellant The Railroad Credit Corporation intends to rely, filed in connection with its present appeal (II-R 166-172).

The corrollary is the position of The Railroad Credit Corporation:

The liens on the Debtor's properties exhausted them. By consequence unsecured claims (including claims of any secured creditor over the value of security held) were worthless, as against the Debtor's estate. The amount of claims (without regard to the security behind them) in no sense measured participation in the Debtor's assets, i.e. the new securities to be issued. The new securities were not to be issued against or in respect of the amount of claims. The new securities were to be issued only against, and measured by, First Mortgage and General and Refunding Mortgage liens on the Debtor's property held by the claimants, whatever the amount of the claims and however much or little the claims might exceed the liens securing them. The unsecured claims, and the unsecured portion of claims secured in part, were immaterial. They were not a factor in determining the amount, character or allocation of new securities. Any factor affecting only unsecured claims, or the unsecured portion of claims which

were secured in part, and not affecting the measure of value of claims, or basis of allotment used (i.e., the First Mortgage Bonds and the General and Refunding Mortgage Bonds held), did not and can not now affect the allotment of new securities.

In the case of The Railroad Credit Corporation new securities were allotted only against General and Refunding Mortgage Bonds held, and **not** against or measured by its claim, **or even any other security which may have been given by the Debtor** (whether a distributive share under the Marshaling and Distributing Plan, 1931, or otherwise). Whatever The Railroad Credit Corporation realizes from the distributive share of the Debtor and its subsidiaries under the Marshaling and Distributing Plan, 1931,—however that may affect its **claim**,—can not affect the amount of common stock to be received by The Railroad Credit Corporation because it does not touch or affect the General and Refunding Mortgage Bonds of the Debtor held by the Credit Corporation, the only measure of new securities used, and the only thing against which—"in respect of" which—they are to be issued, i.e., General and Refunding Bonds held. However, the Plan properly recognized that the Debtor's distributive share under the Marshaling and Distributing Plan, 1931, should reduce the amount of the **claim** of The Railroad Credit Corporation because such reduction might affect rights to accommodation collateral held by The Railroad Credit Corporation.

VI.

ARGUMENT

Resumé of The Railroad Credit Corporation's position

The Railroad Credit Corporation's position in the Reorganization proceeding is to be stated without regard for any accommodation collateral it may hold.

The extent to which the Railroad Credit Corporation receives **actual** satisfaction of its claim through application of the assets of the Debtor (either because it is permitted to retain and apply assets which it holds, or because it receives distribution of new securities representing interests in the property of the Debtor) may affect its right to resort to accommodation collateral. But **as between The Credit Corporation and the Debtor,** and in the adjustment of rights in the reorganization proceedings, it is not material that the Credit Corporation holds accommodation collateral. The assets of the Debtor are primarily responsible for its debts, and are first to be applied to those debts without regard to accommodation collateral. The rights **as between the Credit Corporation and the Debtor** were to be adjusted without regard to accommodation collateral; as though the Credit Corporation held no accommodation collateral. This much, at least, was settled by the decision of the Supreme Court (318 U.S. 448, 503, 87 L.ed. 892, 947)[26].

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26. If additional authorities are necessary, the following will be found fully to support the propositions just stated: *Ivanhoe Bldg. & Loan Ass'n v. Orr,* 295 U.S. 243, 79 L.ed. 1419; *New York Trust Co. v. Palmer,* 101 F.2d 1, 3, col. 2 (C.C.A. 2—applying the rule of the *Ivanhoe Case* under §77); *Matter of Blizard,* 20 F.Supp. 481 (E. Dist., Penn.); *Epstein v. Goldstein,* 118 F.2d 73 (C.C.A. 2); 2 *Remington, Bankruptcy,* 4 ed., §912 et seq.; 1 *Collier, Bankruptcy,* 14 ed., §1.28.

It is the general rule, not peculiar to bankruptcy, that security given by the debtor should be exhausted before accommodation collateral (security given by

Disregarding accommodation collateral, the position of The Railroad Credit Corporation in table form is as follows:

Claim against Debtor, principal and interest (See p. 7 above)			(a)$2,590,924.11
Value of security by way of General and Refunding Mortgage Bonds as found by ICC, not more than (See p. 17 above)	(b)$1,437,346.00		
Amount of Debtor's distributive share under the Marshaling Plan, 1931 (See p. 30 above)	(c)	26,091.72	(d) 1,463,437.72
Part of claim unsecured and uncompensated for on any theory			(e)$1,127,486.39

The basis upon which new securities were to be issued under the Plan of Reorganization—the thing "in respect of" which they were to be issued—was only General and Refunding Mortgage Bonds, (b) in the table above. There was no allocation on account of the distributive share under the Marshaling Plan, (c) in the table above.

The meaning of subdivisions P and R of the Plan of Reorganization, in so far as they touch the Debtor's distributive share under the Marshaling Plan, 1931, is to be determined in these circumstances and in the light of settled rules of law.

The meaning and effect of subdivisions P and R if the Debtor's distributive share under the Marshaling Plan, 1931, is considered as an offset.

If the Debtor's distributive share of moneys held by The Railroad Credit Corporation under the Marshaling

a surety) is resorted to. *Pinckney v. Wiley*, 86 F.2d 541 (C.C.A. 5); *Robbins-Sanford Mercantile Co. v. Johnson*, 166 Ark. 330, 266 S.W. 260, 37 A.L.R. 1258 and note at 1262; *Robinson v. Roe*, 233 F. 936, 940 (C.C.A. 2—cert. den. 242 U.S. 630, 61 L.ed. 536); *Bearse v. Lebowich*, 212 Mass. 344, 99 N.E. 175; *Goodwin v. Mass. L. & T. Co.*, 152 Mass. 189, 25 N.E. 100, 104, top col. 1; *Smith v. Savin*, 141 N.Y. 315, 36 N.E. 338, 341, bot. col. 1.

Plan, 1931, in view of the express provisions of that plan, is to be considered as a contractual offset against any amount due from the Debtor to The Railroad Credit Corporation (see notes 13 and 15 above), as we believe it should be considered (Bankruptcy Act §68(a), 11 U.S.C.A. Sec. 108(a) made applicable by §77(l), 11 U.S.C.A. Sec. 205(l)), the effect is to reduce Credit Corporation's gross claim ((a) in the table p. 35 above). Even with this reduction, the claim so far exceeds the value of the security held in the form of General and Refunding Mortgage Bonds, (b) in the table above, **the only thing against which new securities are to be issued under the Plan of Reorganization,** that the amount of the set-off and reduction of claim is immaterial. The amount of the **claim** in excess of the value of security held had no bearing, under the Plan of Reorganization, on the amount of new securities to be issued or the allocation of new securities. It is of no consequence what the amount of the **claim** is so long as its net amount, over and above all set-offs and the value of all security originally held and dealt with in the Plan of Reorganization ((e) in the table above at p. 35), is $1.00 or more.

The construction and application of subdivisions P and R of the Plan of Reorganization if the Debtor's distributive share under the Marshaling Plan, 1931, be considered as property of the Debtor pledged by the Debtor.

If the Debtor's share under the Marshaling and Distributing Plan is considered as property of the Debtor pledged to The Railroad Credit Corporation, then it was property in the possession of The Railroad Credit Cor-

poration, upon which the Credit Corporation had a first lien as senior creditor (see p. 11 et seq. above). Indeed, no other creditor had any lien on it. The portion of the Credit Corporation's claim against the Debtor, over and above the value of General and Refunding Mortgage Bonds held by the Credit Corporation, i.e. the otherwise unsecured portion of the Credit Corporation's claim, was more than enough to exhaust this additional security. Moreover, this security, on this assumption, was as good as cash—it had a dollar per dollar value. As to the Debtor's distributive share under the Marshaling Plan, 1931, the position of The Railroad Credit Corporation was like, but stronger than, the position of the RFC in *In re Chic. & N.W. Ry. Co.*, 126 F2d 351, 369 (C.C.A. 7—cert. den. 318 U. S. 793, 87 L. ed. 1158, reh. den. 319 U. S. 781, 87 L. ed. 726)[27].

As to the Debtor's distributive share under the Marshaling Plan, 1931, the Credit Corporation's claim being the only lien upon it, and being sufficient to fully exhaust it (after giving due consideration to any other security held), the Credit Corporation was in precisely the position of the holders of equipment trust certificates, the Baldwin lease and the Pullman contract (see subd. P-1, p. 26 above. Cf. Q, I-R 393, I-R 122, 126, 127, 145-147, 175, 202, 205, 206, 224-227, 248, 261, 277, 285, 343)[28]. The opinion of the Supreme Court (318 U. S. at 456, 87 L. ed. at 422, col. 1) says:

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27. "The RFC held collateral security which it could convert into cash at any time. No other group of bondholders was secured by marketable collateral security of the approximate value of its debt. If the reorganization plans are to be upset and all bondholders and all groups put back in their old position, the RFC could now realize the full amount of its claim through the sale of its collateral. Likewise, if we assume that the plan be rejected and the proceedings dismissed, its legal right so to do would be clear."

28. These are also dealt with in the Bureau's proposed report I-R 122, 126, 127, 145-147, 175, in the Commission's original report and plan I-R 202, 205, 206, 224-227, 248, 261, 277, 285 and in the final report I-R 343.

> "The equipment obligations of $2,750,050 are secured by rolling stock, acquired free of the liens of mortgages, through direct liens or trust arrangements. No one disputes the sound character of any of these securities. They are given priority over the fixed obligations of the reorganized company."

The Railroad Credit Corporation was entitled to the same sort of treatment, i.e., treatment which would permit it to fully exhaust this security and to do so upon a dollar for dollar basis. No reason for differentiation or discrimination has been, or can be, suggested.

Where, as appears from the table at p. 35 above, a creditor holds a first and senior lien on property and has a claim which will fully exhaust that property, he is entitled to exercise the full measure of his rights. "The right to retain a lien until the debt secured thereby is paid is a substantive property right which may not be taken from the creditor consistently with the Fifth and Fourteenth Amendments to the Constitution. *Louisville Joint Stock Land Bank v. Radford,* 295 U.S. 555, 594, 79 L. ed. 1593, 55 S. Ct. 854, 97 A.L.R. 1106." (*Security-First Nat. Bk. v. Rindge Land & Nav. Co.,* 85 F.2d 557, 561,[29] reh. den. 86 F.2d 3 (C.C.A. 9—cert. den. 299 U. S. 613, 81 L. ed. 452, reh. den. 300 U. S. 686, 81 L. ed. 888)[30].

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29. The court added: "Section 77B, subd. (a), 11 U.S.C.A. §207(a) gives the court equity powers, but it does not purport to alter long established incidents of property by introducing a vague and indefinable 'equity' into the proceedings. See *In re Judith Gap Commercial Co.* (C.C.A. 9), 5 F.2d 307, 309."

30. The *Security-First National Case* is quoted with approval and followed in *Horn v. Ross Island Sand & Gravel Co.,* 88 F.2d 64, 65 (C.C.A. 9) and the court adds: "The Plan of Reorganization is to pay the bondholders only 40 percent. of their obligations, such payment being derived from only a portion of the property upon which the bondholders have a lien and to release other property subject to the lien to the debtor and its general creditors. The Plan cannot stand against the objecting bondholders. That the interest of the appellant bondholder is small as compared with the interest of all the other bond-

The **full** priority rule of *Northern Pac. Ry. Co. v. Boyd* 228 U.S. 482, 57 L. ed. 931, is incorporated in §77(e) through the phrase "fair and equitable". *(Institutional Investors v. Chic., M., St. P. & P. R. Co.,* 318 U.S. 523, 541, 87 L. ed. 960, 995, col. 1,[31] decided the same day that *Ecker v. W. P. R. Corp.,* approving the plan of Reorganization here involved, was decided.) "Full compensatory provision must be made for the entire bundle of rights which the creditors surrender." *(Consolidated Rock Products Co. v. Du Bois,* 312 U.S. 510, 528, 85 L.ed. 982, 944.[32])

Senior security holders cannot be deprived of their rights on any basis of equitable adjustment or composition. The Supreme Court said in *Marine Harbor Properties v. Manufacturer's Trust Co.,* 317 U.S. 78, 85, 86, 87 L. ed. 64, 69:

> "Admittedly the property is worth less than the amount of the First Mortgage indebtedness. * * * Ap-

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holders and stockholders does not alter the fact that the appellant has been deprived of property to which he is justly entitled. This cannot be done."

The *Security-First National Case* is cited with approval in *In re Day & Meyer, Murray & Young, Inc.,* 93 F.2d 657, 658, col. 2 (C.C.A. 2), for the proposition that bondholders cannot be deprived of their lien on the debtor's property. The court disapproved a plan which would permit general creditors or stockholders to share with bondholders by giving common stock to all. "Such a plan does not preserve priorities. See *Northern Pac. Ry. Co. v. Boyd,* 228 U.S. 482, 33 S.Ct. 554, 57 L.ed. 931. The arrears of interest is also secured and entitled to priority over the general creditors and preferred stockholders. In their interest claims, the bondholders should be protected. They are not protected under the plan for they are given only common stock."

31. "If it is established that there is no reasonable probability of such earning power, then the inclusion of the stock would violate the full priority rule of *Northern Pac. Ry. Co. v. Boyd,* 228 U.S. 482, 57 L.ed. 931, 33 S.Ct. 554—a rule of priority incorporated in section 77(e)(1), as in section 77B and Chap. X (*Case v. Los Angeles Lumber Products Co.,* 308 U.S. 106, 84 L.ed. 110, 60 S.Ct. 1, 41 Am. Bankr. Rep. (N.S.) 110, supra; *Marine Harbor Properties v. Mfgr's Trust Co.,* decided Nov. 9, 1942 [317 U.S. 78, 87 L.ed. 64, 63 S.Ct. 95, 51 Am. Bankr. Rep. (N.S.) 1]) through the phrase 'fair and equitable'."

32. In *Institutional Investors v. Chic., M., St. P. & P. Ry. Co.,* 318 U.S. 523, 556, 87 L.ed. 960, 1102, bot. col. 2, the court said, speaking of the *Du Bois Case:* "We held * * * that in applying the full priority rule of the *Boyd Case* (228 U.S. 482, 57 L.ed. 931, 33 S.Ct. 554) and the *Los Angeles Lumber Products Co. Case* (308 U.S. 106, 84 L.ed. 110, 60 S.Ct. 1, 41 Am. Bankr. Rep. (N.S.) 110) full 'compensatory provision must be made for the entire bundle of rights which the creditors surrendered'."

proval of the petition on the grounds advanced by the District Court could be made only under the composition theory of reorganization which Chap. X, like §77B, rejected in favor of the full priority rule of the *Boyd Case.* See *Case v. Los Angeles Lumber Products Co.,* supra. **That rule protects the rights of senior creditors against dilution either by junior creditors or by equity interests.''**[33]

In *Institutional Investors v. Chic., M., St. P. & P. R. Co.,* 318 U.S. 523, 562, 569, 87 L. ed. 960, 1006 col. 1, 1009 col 2 the court said:

> ''In case of first and second liens on the same property, senior lienors, of course, would be entitled to receive, in case the junior lienors participated in the plan, not only 'a face amount of inferior securities equal to the face amount of their claim', but in addition 'compensation for the senior rights' which they surrendered. (*Consolidated Rock Products Co. v. Du Bois,* supra, 312 U.S. p. 529, 85 L. ed. 995, 61 S. Ct. 675, 45 Am. Bankr. Rep. (NS) 79) * * * Hence, as we indicated in the *Consolidated Rock Products Co. case,* where junior interests participate in a plan and where the senior creditors are allotted only a face amount of inferior securities equal to the face amount of their claims, they 'must receive, in addition, compensation for the senior rights which they are to surrender'. * * * **Unless that principle is respected, there will be serious invasions of the rights of senior claimants to the benefit of junior interests. The property of one group will be subtly appropriated to pay the claims**

33. This language was quoted with approval in *Institutional Investors v. Chic., M., St. P. & P. R. Co.,* 318 U.S. 523, 569, 87 L.ed. 960, 1009, col. 2, and the court added: ''That view has not been contested here.''

of another while lip service is rendered the principles of priority.'' [34]

In addition to the cases just referred to, and the cases cited in those cases, the following may be consulted:

Re 620 Church Street Bldg. Corp., 299 U.S. 24, 81 L. ed. 16;

Security-First Nat. Bk. v. Rindge Land & Nav. Co., p. 38 above;

Horn v. Ross Island Sand & Gravel Co., note 30 above;

In re Day & Meyer, Murray & Young, Inc., note 30 above;

Price v. Spokane Silver & Lead Co., 97 F.2d 237 (C.C.A. 8);

Sophian v. Congress Realty Co., 98 F.2d 499 (C.C.A. 8);

Tellier v. Franks Laundry Co., 101 F.2d 561 (C.C.A. 8);

Metro. Holding Co. v. Weadock, 113 F.2d 207 (C.C.A. 6);

Whitmore Plaza Co. v. Smith, 113 F.2d 210 (C.C.A. 6).

The Credit Corporation had a prior and senior lien on the Debtor's distributive share under the Marshaling and Distributing Plan, 1931. As to this distributive share RCC was the sole secured and senior creditor. No one else had any lien on that distributive share. It was the Credit Corporation's property. Credit Corporation was given nothing

34. In the *Consolidated Rock Products Co. Case* the court said (312 U.S. at 529, 85 L.ed. at 995), speaking of senior creditors: ''If they receive less than that full compensatory treatment, some of their property rights will be appropriated for the benefit of stockholders without compensation. That is not permissible. The plan then comes within judicial denunciation because it does not recognize the creditors' 'equitable right to be preferred to stockholders against the full value of all property belonging to the debtor corporation'.''

in exchange for it under the Plan of Reorganization. If it is to be applied to reduce securities allocated to Credit Corporation but not issued against it, and issued against something else—is to be applied to reduce the amount of common stock the Credit Corporation is to receive—**the practical effect is to use it to pay other claims.** The practical effect is to violate the rule of *Institutional Investors v. Chicago, M., St. P. & P. R. Co.,* 318 U.S. 523, 570, 87 L. ed. 959, 1010, that the *Boyd Case* is to be adhered to, and that

> "unless that principle is respected, there will be serious invasions of the rights of senior claimants to the benefit of junior interests. The property of one group will be subtly appropriated to pay the claims of another while lip service is rendered the principles of priority."

With deference, the lower court's construction of subdivisions P and R of the Plan of Reorganization, does violence to the rules just noticed.

The practical effect of the decision is to treat the Debtor's distributive share under the Marshaling Plan, 1931, as though it were only the equivalent of common stock at the arbitrary factor (see p. 52 below) of $62 per share. On this hypothesis Credit Corporation is directed to surrender common stock at $62 per share to the amount of the Debtor's distributive share under the Marshaling Plan received and applied by the Credit Corporation during the period December 31, 1938 to date of consummation of the plan (December 29, 1944). **Upon the District Court's hypothesis the result would be the same if Credit Corporation received the common stock originally allotted to it and surrendered to the Debtor the Debtor's distributive share ap-**

plied under the Marshaling Plan, during the foregoing period, receiving nothing in return, since the common stock was to be issued only against, and in respect of, General and Refund Mortgage Bonds held.

The history of the Plan of Reorganization demonstrates that no such result was intended. To the contrary, while such a treatment of the distributive share had at one time appeared in the Plan of Reorganization, it was deliberately written out.

In the Commission's **original report** of October 10, 1938, the Commission concluded that the Plan should provide that collateral pledged by the Debtor to Reconstruction Finance Corporation, Credit Corporation and James Co. should be surrendered to the Debtor, and continued:

> "**The Railroad Credit Corporation also should release and surrender to the reorganized company its rights and interest in the debtor's distributive shares under the Marshaling and Distributing Plan, 1931,** from and after the effective date of the plan, and any proceeds from such shares applied by the Railroad Credit Corporation to the payment of principal and/or interest of and upon the obligations of the debtor after the effective date of the plan, unless such application shall have been made by the authority of the Court of competent jurisdiction, shall be turned over to the reorganized company." (I-R 280.)

The Commission's **original order and plan** of the same date provided:

> "The Railroad Credit Corporation also shall release and surrender [to] the reorganized company all its rights and interest in the debtor's distributive share under the Marshaling and Distributing Plan, 1931, from and after the effective date of the plan, and any

proceeds from such shares applied by The Railroad Credit Corporation to the payment of principal and/or interest of and upon the obligations of the debtor after the effective date of the plan, unless such application shall have been made by authority of the Court of competent jurisdiction, shall be turned over to the reorganized company." (I-R 297, 298.)

On the promulgation of this report and the order The Credit Corporation filed a petition for modification (I-R 675 et seq.). This petition, making the point that "the right to retain a lien until the debt secured thereby is paid is a substantive property right" protected by the Constitution *(Security-First National Bank v. Rindge etc. Co.,* 85 F.2d 557 [C.C.A. 9])[35] objected to this provision (I-R 686 et seq.). In this behalf Credit Corporation pointed out:

> "In the absence of a voluntary acquiescence by the RCC, which has not been given, these provisions are completely unwarranted and cannot be supported in Court. The rights of the RCC do not rest upon a Court order and the RCC cannot be required to seek a Court order as a condition precedent to the exercise of its rights.
>
> "It may be noted in this connection that the claim of the RCC, as classified by the Reorganization Court, constitutes an entire class of claims. * * *
>
> "Not only is the RCC entitled as pledgee to receive and apply the distributive shares of the Debtor, under the terms of the Marshaling and Distributing Plan, 1931, to which both the RCC and the Debtor are parties, the RCC has the right and is in duty bound not to pay distributive shares in cash to participating

35. See p. 38 above.

carriers that have borrowed from and are indebted to the RCC, but instead to credit such shares upon such indebtedness.'' [36]

The petition then suggested that there should be inserted a provision, contained in the Commission's order in *Chicago Great Western Railroad Company Reorganization,* F.D. No. 10772, as follows:

> ''Nothing in the foregoing and other provisions herein with respect to The Railroad Credit Corporation is intended to limit or in any manner affect the right of that corporation to apply, in its discretion, the income on and proceeds of the collateral held by it, to or toward the payment of the principal, or interest, or both, of or upon its **claim** against the Debtor prior to the consummation of the reorganization.''

Very considerable other opposition developed to the Commission's originally proposed Plan of October 10, 1938. As appears from Institutional Bondholders' Committee's petition for modification (I-R 753 et seq.) there was danger that the plan would fail of confirmation by the creditors. To prevent this the Bondholders' Committee endeavored to negotiate with the creditors to bring them to agreement, and, having failed, by its petition for modification submitted a new plan which it felt would be sufficiently satisfactory ultimately to be put into operation. Sensitive to the point made in the Credit Corporation's petition for modification this modified plan contained the following:

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36. See p. 13 et seq. above.

"4. RCC will receive in respect of its claim in the principal amount of $2,445,610, together with $146,503 of interest accrued and unpaid thereon to January 1, 1939 (subject to the reduction **of said amount**[37] by the application, prior to the date of issue of the new securities under the capitalized plan, of any proceeds from the distributive shares of the company or its subsidiaries under the Marshaling and Distributing Plan, 1931): 37,030 shares common stock * * *."

The Commission, in its supplemental report of June 21, 1939, modified its original report and plan in some respects (not in all). One modification had to do with treatment of the Debtor's distributive share under the Marshaling and Distributing Plan, 1931. The modification goes back to the Credit Corporation's suggestion (p. 45 above) and to the modification in the Bondholders' Committee's plan. In its report the Commission said:

"Under the bondholders' committee's modified plan, existing mortgages on the Debtor's properties would be released and cancelled, * * *. All collateral pledged by others than the Debtor * * * would be surrendered to the pledgors thereof, and **all collateral pledged by the Debtor** as security for such notes would be reduced to possession by the respective pledgees thereof, and would then be by them surrendered to the reorganized company and cancelled, **except** that the Credit Corporation would **not** release or surrender any right or interest in the distributive shares of the Debtor or its subsidiaries under the Marshaling and Distributing Plan, 1931, **but any pro-**

37. Notice the marked change. The distributive share of the Debtor is not to be "released and surrendered" directly or through reduction in the amount of new securities. Only the amount of the **claim** is to be reduced. This is just what The Railroad Credit Corporation suggested should be done as in the *Chicago Great Western* matter. See p. 45 above.

ceeds from such distributive shares after the effective date of the Plan, would become the property of and be retained by the Credit Corporation, but to the extent to which received prior to the issue of the new securities under the plan would be applied in reduction of the claim of the Credit Corporation.

"Conclusion.—We do not approve that part of the foregoing provisions which states that all collateral pledged by others than the Debtor as security for the Debtor's notes to the Finance Corporation, Credit Corporation, and James Company would be surrendered to the pledgors thereof. With this provision eliminated we approve the foregoing provisions." (I-R 344, 345.)

As matter of reasoned choice the Credit Corporation was not required to surrender any part of the Debtor's distributive share. Upon objection such provision had been deliberately removed from the Plan. It is equally clear that none of the new securities were issued against or in relation to this distributive share. The history of the provisions under consideration demonstrates that as a matter of deliberate choice, receipt of anything by the Credit Corporation from the Debtor's distributive share was to go to reduce the amount of Credit Corporation's "claim", and was to do nothing more. When the Commission used the work "claim" it meant exactly that and no more. The distributive share occupies no lesser position than that of any other pledged collateral in the possession of a pledgee, the income and proceeds from which are received and applied against principal or interest or both of the claim secured thereby. (See Orders Nos. 100 and 101 of District Court of Connecticut in the reorganization proceedings of the New York, New Haven and Hartford Railroad Company

reported on pages 2689-2697 and 2829 of printed court records of said proceedings. See also printed record pages 3533-3534 of reorganization proceedings of St. L. SW. Ry. Co. where similar ruling was made.)

There is nothing in the language of the Plan of Reorganization which compels disregard of the rule of the *Boyd Case* and the other considerations just noticed. To the contrary, full effect can be given to them, and the full measure of compensation to which the Railroad Credit Corporation is entitled can be afforded to it, if the Plan of Reorganization is taken and applied as it is written and clearly intended.

The construction which the District Court puts on the Plan of Reorganization not only disregards the considerations to which we have called attention, and denies to The Railroad Credit Corporation the "full compensation" for "its entire bundle of rights"—fails to protect its rights against dilution by junior interests and subtly appropriates its property to pay the claims of others—but distorts and really re-writes the Plan of Reorganization.

Subdivision P, paragraph 4 of the Plan of Reorganization provides:

> "The Railroad Credit Corporation shall receive in respect of its claim in the principal amount of $2,455,-610 [$2,445,610][38], together with $146,503 of interest accrued and unpaid thereon to January 1, 1939 (subject to the reduction of said amounts by the application, prior to the date of issue of the new securities under the plan, of any proceeds from the distributive shares of the company or its subsidiaries under the

38. See note 21 above.

Marshaling and Distributing Plan, 1931), * * * and 35,425 shares of common stock (being common stock taken at the price of $62 per share)."

The court below construes this as though it reads:

"The Railroad Credit Corporation shall receive in respect of its claim * * * (subject to the reduction **of the common stock hereinafter referred to at the rate of one share for every $62 received,** prior to the date of issue of the new securities under the plan, of any proceeds from the distributive shares of the company or its subsidiaries under the Marshaling and Distributing Plan, 1931), * * * and 35,425 shares of common stock."

Subdivision R of the Plan of Reorganization provides:

"All collateral pledged by the Debtor to * * * shall be surrendered by them to the reorganized company and cancelled, except that the Railroad Credit Corporation shall not release or surrender any right or interest in the distributive share of the debtor or its subsidiaries under the Marshaling and Distributing Plan, 1931, but any proceeds from such distributive share, after the effective date of the Plan shall become the property of and be retained by the Railroad Credit Corporation, but to the extent to which received prior to the issue of the new securities under the plan shall be applied in reduction of **the claim** of the Railroad Credit Corporation in respect of which such new securities are to be issued **at the rates provided in subdivision P.**"

So far as the quoted provision contains operative language, as distinguished from language of mere description, it provides only for "reduction of the **claim**". What follows

merely identifies the claim as the claim "in respect of which new securities are to be issued at the rates provided in subdivision P". The language is not at the "rate" (singular) provided for issuance of the common stock, but at the "rates", which obviously refers to the bonds and preferred stock as well. The court construes this provision as though it read:

> "* * * except that the Railroad Credit Corporation shall not release or surrender * * * but any proceeds from such destributive shares * * * shall become the property of and be retained by the Railroad Credit Corporation but to the extent to which received prior to the issue of the new securities under the plan shall be applied in reduction of **the common stock to be received by the Railroad Credit Corporation,** said reduction to be made **at the rate provided in subdivision P, paragraph 4, for said common stock.**"

The reasons suggested by the District Court do not support its order

The District Court gave three reasons for its conclusion that the common stock distributable to The Railroad Credit Corporation should be reduced (II-R 105, 106):

> 1. Unless this construction be given the language of subdivisions P and R, referring to the Debtor's distributive share under the Marshaling and Distributing Plan, 1931, "becomes mere surplusage".
>
> 2. The intention that the amount of common stock distributable shall be reduced is indicated by subdivision R which describes the "claim" which is to be reduced by the distributive share as "the claim of The Railroad Credit Corporation in respect to which new securities are to be issued **at the rates** provided in subdivision P".

3. This intention appears from the qualifying word "approximately" which appears before the description of the securities to be received by Railroad Credit Corporation in Paragraph 4 of subdivision P, the Court noticing that this word is not used in Paragraph 5 describing the securities to be issued to the James Company which had no interest in any distributive share.

We take up these reasons in inverse order.

1. With deference, no support can be found in the use of the word "approximately". Its use was not necessary. While it is used in subdivision P of the plan it was not used in the corresponding portions of the report which underlay and accompanied the Plan (see p. 23 above). In subdivision P "approximately" is not used in Paragraph 5 dealing with the James Company. **But it IS used in Paragraphs 2 and 3 dealing with the first mortgage bondholders and the Reconstruction Finance Corporation.** In those paragraphs it is used in exactly the way in which it is used in Paragraph 4 dealing with The Railroad Credit Corporation. **Neither the first mortgage bondholders nor the Reconstruction Finance Corporation had any interest in any distributive share.** We respectfully call attention to paragraphs 2 and 3 of subdivision P quoted above at p. 26. The reason for use of this cautionary word is patent.[39]

2. Nor, with deference, can support be drawn from the use of the words "at the rates" used in subdivision R. All that R was doing was identifying the claim of The Rail-

39. The obvious reason for use of the word was to allow for minor adjustments, correction of clerical errors, etc. Indeed, need for one such adjustment was found by the Reorganization Committee and adjustment was made on petition (II-R 70-72), opinion (II-R 98-100) and order (II-R 144, 146) in the very proceeding out of which this appeal grows.

road Credit Corporation. It identified it as the claim against which described securities were to be issued. It naturally went back, for its language, to subdivision P where that subject was dealt with. R referred not to the rate for the common stock but "to the rates". Again, there was no distinction drawn in P between the first mortgage bondholders, Reconstruction Finance Corporation and The Railroad Credit Corporation in form of language (see p. 26 above). Subdivision P, Paragraph 2, deals with the common stock to go to the holders of first mortgage bonds, and the plan adds "(being common stock taken **at the price** of $57 a share * * *)". The same form is used as to Reconstruction Finance Corporation in Paragraph 3—it is to get 15,788 shares of common stock "(being common stock taken **at the price** of $57 a share * * *)". And this same form is then repeated as to The Railroad Credit Corporation. It is to get 35,425 shares of common stock "(being common stock taken **at the price** of $62 per share)".

But there is a more deep-seated difficulty than mere use of language, and comparison of uses. Neither the Commission nor its Plan used $62 for the common stock as a measure of the sound value of that stock; $62 was not used as a measure or basis for exchange of that stock where the exchange was to be for cash or for sound security worth its face value.

The Plan of Reorganization states a factor of $62 per share for the common stock to be received by the Credit Corporation. The District Court, in the order appealed from, adopts this factor and uses it. But this factor of $62 per share was not a factor logically and rationally arrived

at upon a finding, or even an assumed basis, of real value, made or reached **before** determination of the amount of common stock to be received by the credit Corporation. The amount of common stock to be received by the Credit Corporation was determined in a wholly different way—by determining the amount remaining after satisfying the claims of the first mortgage bondholders and the Reconstruction Finance Corporation, and then dividing this amount between Credit Corporation and James Co. in proportion to the amount of General and Refunding Bonds held by each. The distribution having been determined upon in this way, the factor of $62 per share was a mere **result** of the distribution, as distinguished from a basis for it—a result of comparison of the number of shares of common stock to the total claim of the Credit Corporation,[40] after allowance for income-bonds and preferred stock to be issued. This factor was in this sense purely arbitrary. Its statement was only another form of stating the overall priority position of the first mortgage bondholders and the RFC; of stating that they were entitled to priority treatment and, having better security, were entitled to more common stock per dollar of bonds held.

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40. It works out within $29 (less than ½ of one share @ $62) on the figures used by the Commission in subdivision P 4 of the Plan of Reorganization (I-R 391, quoted at p. 26 above) and used in the opinion of this Court (124 F.2d at 137, col. 2). It misses the figures used in the opinion of the District Court (34 F.Supp. at 497, I-R 1576) and in the opinion of the Supreme Court (318 U.S. at 455, 87 L.ed. at 922; quoted above at p. 7) by $1,221.89 (19 plus shares @ $62), increased by $26,091.72 to a difference of $27,313.61 (440 plus shares @ $62) if the Debtor's distributive share under the Marshaling Plan, 1931, is treated as an off-set reducing the Credit Corporation's gross claim.

The ICC and CCA figures for the RCC gross claim are $2,592,113. The D. C. and Supreme Ct. figures for the RCC gross claim are $2,590,924.11.

35,425 shares of Common Stock @ $62 come to $2,196,350. The new securities to RCC on this basis are:

Bonds	$ 154,111
Preferred Stock	241,681
Common Stock	2,196,350
	$2,592,142

That it in no sense reflected value of the common stock, is demonstrated by the fact that there is assigned to the common stock for purposes of conversion of Income Bonds a factor of $50 per share (318 U.S. at 461, 87 L.ed. at 925, note 5, quoted at p. 10 above; Plan of Reorganization subdivision J, I-R 374) and for purposes of distribution to holders of first mortgage bonds a factor of $57 per share (Plan of Reorganization subdivision P 3, I-R 391, quoted at p. 26 above). If the same method of arriving at a factor were used in the case of the James Co. (a creditor to whom distribution was made on exactly the same basis as distribution was made to the Credit Corporation, i.e., on the basis of the proportion of General and Refunding Bonds held) the factor would be $154 plus.[41]

3. Finally, the District Court suggested that unless its construction were adopted, the language of Subdivision P, paragraph 4, referring to reduction of the amount of the claim of The Railroad Credit Corporation would be mere surplusage. With deference, the Court is in error.

There was a real reason why the Plan should expressly provide that receipts by The Railroad Credit Corporation of the Debtor's distributive share under the Marshaling Plan, 1931, should reduce the "**claim**" of The Railroad Credit Corporation. This would not affect the securities to be issued to The Railroad Credit Corporation, but it might bear materially upon the rights of The Railroad Credit Corporation and The Western Pacific Railroad *Corporation* in the accommodation collateral held by The Railroad

41. This, as between RCC at 62 and James Co. at 154, would not reflect a priority in class of claim or security, but only a higher proportion of security to debt. It would reflect nothing more for any purpose.

Credit Corporation and supplied by The Western Pacific Railroad Corporation.

This accommodation collateral consisted of three items (see note 9 above). The first was an unsecured claim of The Western Pacific Railroad Corporation against the Debtor for $5,494,722. It had been assigned to The Railroad Credit Corporation. It was, of course, worthless. But the other two items were not worthless. At least there is no showing that they were worthless and the appeal taken by The Western Pacific Railroad Corporation from another part of the lower court's order of September 14, 1944 is a fair indication that they are not worthless. These two items, as they are shown in the record, and stated in the opinion of the District Court (see note 9 above), are claims of The Western Pacific Railroad Corporation against

Standard Realty and Development Company	$120,000	
Sacramento Northern Railway	$856,260	$976,260

assigned to The Railroad Credit Corporation. There has been some reduction in the indebtedness of Standard Realty and Development Company. But it is apparent that the amount of these claims is reaching toward the limit of the unsecured portion of the claim of The Railroad Credit Corporation (see p. 35 above). At the time the Interstate Commerce Commission promulgated its final report and final Plan of Reorganization on June 21, 1939, it was conceivable that the unsecured portion of the claim of The Railroad Credit Corporation might be reduced to a figure below the then figure of $976,260 of accommodation

collateral security held by The Railroad Credit Corporation and not then demonstrated to be worthless.

If the unsecured portion of the claim of The Railroad Credit Corporation should be reduced below $976,260 The Western Pacific Railroad Corporation would be very much interested. Some of the accommodation collateral furnished by it would be in position to be released to it. This is the reason that the Commission's final Plan of Reorganization provided that anything received by The Railroad Credit Corporation from the Debtor's distributive share under the Marshaling Plan, 1931, should be applied to reduce its "claim" against the Debtor. The provision, on the construction we urge, was not mere surplusage.

CONCLUSION

It is respectfully submitted that unless there are compelling reasons to the contrary, to be found in the Plan of Reorganization itself—and there are none—the Plan should be given a construction in harmony with the rule of the *Boyd Case* and the considerations noticed above at pages 35 to 42.

It is respectfully submitted that Finding and Conclusion (b) of the District Court's Order of September 14, 1944 is without support in law or in fact and that paragraph (3) of the same order is erroneous; that these portions of the order should be reversed with directions to strike them from the order, and to enter an order that anything received by The Railroad Credit Corporation on account of the Debtor's distributive shares under the Marshaling and

Distributing Plan, 1931, during the period December 31, 1938 to December 29, 1944, be retained by The Railroad Credit Corporation as its own, that to the extent of such receipts by The Railroad Credit Corporation, prior to the issuance of the new securities, the claim of The Railroad Credit Corporation against the Debtor (principal and interest) be reduced, but that such reduction of the claim of The Railroad Credit Corporation shall not affect the character or number of new securities to be issued to it and it shall receive securities as provided in subdivision P, paragraph 4 of the Plan of Reorganization, without reduction on account of any security held by it over and above General and Refunding Mortgage Bonds.

Dated at San Francisco, April 18, 1945.

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